TRG law

law simplified

ACTING REASONABLY

Introduction

'Reasonable' and 'reasonably'. These must surely be any lawyer's favourite words – they are used repeatedly in a number of different contexts: 'consent not to be unreasonably withheld or delayed', 'reasonable endeavours', 'reasonable notice', 'reasonably implied', 'as may be reasonably necessary'; the list goes on.

In one recent set of contract terms the word 'reasonable/reasonably' was used 77 times; in another it was used 201 times! So one would assume that everyone would have a good idea of what 'reasonable' and 'reasonably' actually means? Unfortunately that may not always be the case.

English law does not traditionally recognise any general obligation on a contracting party to 'act reasonably'. It does not (unlike many continental European jurisdictions) impose a general obligation on contracting parties to act 'in good faith' towards each other – but more of that later. This may be one of the primary reasons why English lawyers in particular seem to like the word 'reasonable' quite so much for fear that the other contracting party might decide to act completely unreasonably. However, it would seem that the Courts do place some constraints on behaviour irrespective of what the written contract says.

There have been several cases in recent years which all, to a greater or lesser degree, have involved the concept of 'reasonableness' and this is a summary of the current position under English law.

CONSENT NOT TO BE UNREASONABLY WITHHELD OR DELAYED

How will this phrase be construed when used in a contract?

To answer this, it is necessary to look at various cases in which this phrase was used. It is most often seen in the context of requests for permission to assign or sub-contract but is also seen in an IT context where acceptance tests are involved and the supplier does not want confirmation of acceptance to be 'unreasonably withheld or delayed' or in relation to other contractual approvals sought.

Onus on party seeking consent

The case of *Porton Capital v 3M* [2011] looked at which party has to show whether consent was reasonably withheld or not. The context of this case was a request for permission to cease active marketing of a particular product which was the subject of an earn out provision.

The consideration to which the sellers were entitled was directly related to future sales of the product in question. 3M was not allowed to stop active marketing without the sellers' consent and so sought permission to do so. Porton was contractually obliged not to unreasonably withhold its consent.

The onus was on the party seeking consent to establish, on the balance of probabilities (ie that it was more likely than not), that the party withholding consent was acting unreasonably.

Importantly, and perhaps surprisingly, Porton (the party from whom consent was sought) was not obliged to consider the costs to 3M of continuing with the business but only its own interest in securing the maximum possible earn out.

Therefore, whereas 3M might have been acting perfectly reasonably had it decided to cease active marketing without the contractual commitment because of the losses it was incurring, this was not the case in the context of this contractual provision.

⇨The party asked to give consent is not obliged to consider matters which are entirely unconnected with the contractual relationship in question.

Consent to assign or sub-contract

In relation to requests for permission to assign or sub-contract a contract, the question of when consent can reasonably be withheld and on what basis was examined in *British Gas v Eastern Electricity* in 1996.

Eastern Electricity withheld its approval to an assignment which British Gas was required to obtain under the contract, as it was trying to engineer a right of termination which had not yet accrued.

The Court took a dim view of this and held that Eastern Electricity had acted unreasonably.

It made it quite clear that the decision whether or not to grant consent must relate to the suitability of the proposed assignee/sub-contractor in relation to the particular contract in question and must not take account of 'wider commercial interests'.

Regarding the purpose of the relevant clause, the Court said, "*the primary, if not the sole purpose, of the power of approval was ... to enable the remaining party … to ensure that the party seeking approval was replaced by a satisfactory substitute able to [perform] the contract for the remainder of its term* ".

Given that it seemed to be common ground between the parties that the new company was unobjectionable as a supplier, the Court's decision was perhaps not surprising.

Do reasons for refusal need to be given?

Apparently not. However, as the judge in *Lymington Marina v McNamara [2007]* commented, the absence of any justification for not granting permission may be taken as indicating that no proper reasons exist.

'COMMERCIALLY REASONABLE MANNER'

What if a party is required to give consent in a 'commercially reasonable manner'?

In *Barclays v UniCredit (CA)* [2014], this was the requirement for Barclays when its consent had to be obtained in order for UniCredit to terminate some guarantees early in certain circumstances. The contract explicitly provided that Barclays had to act in a 'commercially reasonable manner' when deciding whether to grant consent.

Barclays refused to give its consent unless it was paid the balance of the fees due for a minimum of five years. UniCredit argued it had not behaved in a 'commercially reasonable manner'.

The High Court held that it is the manner of the determination that has to be commercially reasonable and not the outcome.

Barclays had withheld consent in the manner required which was upheld by the Court of Appeal.

The question was whether a reasonable commercial man in Barclays' position might have reached the same decision.

In determining what was commercially reasonable, Barclays was entitled to take into account its own commercial interests in preference to those of UniCredit.

It was not obliged to carry out a balancing exercise between its interests and UniCredit's interests.

If the demand made by Barclays had been completely out of all proportion or if there had been a blanket refusal that may have indicated that it had acted unreasonably.

DRAFTING IMPLICATIONS

- To ensure that a balancing exercise does have to be undertaken when a decision regarding consent is to be made, use clear wording to that effect within the contract.
- Alternatively, expressly state in the contract any specific factors which must be considered by the party from whom consent is sought.

SIMPLE CONSENT

What if the contract simply requires consent or approval but says nothing more?

This was the situation in the *Lymington* case mentioned above. The licensee had a right to moor a boat in a marina and was permitted to grant sub-licences of limited duration to a third party provided the Marina had approved the proposed licensee first.

The clause said nothing about the basis upon which approval could be withheld.

The Court nevertheless held that the scope of the Marina's power of refusal was limited to grounds arising out of the proposed sub-licensee's identity and its suitability to use the marina.

Importantly the Court said that the Marina could not withhold consent arbitrarily and had to act in good faith.

⇨ The party withholding approval/consent does not need to prove that the decision it arrived at was objectively justifiable, merely that a person acting reasonably might have come to the same decision.

ABSOLUTE DISCRETION

What if the contract allows a party absolute discretion when giving consent?

This was the scenario in another clause in the *Lymington* case referred to above which allowed the licence holder to assign the licence subject to the proposed assignee being approved by the Marina. It further provided that such approval could be granted or withheld at the Marina's 'absolute discretion'.

Nevertheless the Court still said that the power to withhold approval had to be exercised in good faith and that consent could not be withheld arbitrarily.

This followed the case of *The Product Star* in 1993 where the Court of Appeal similarly held that not only must discretion be exercised honestly and in good faith, but it must also not be exercised "*arbitrarily, capriciously or unreasonably*". This is a phrase which the Courts have used in other contexts – see below.

Despite the 'absolute discretion' wording, the Court nevertheless also commented that, "*The power to refuse to approve an assignee may only be exercised on grounds which relate to the proposed person and his suitability as an assignee or user... Such power may not be exercised so as to further the [broader] commercial interests of the party withholding consent*".

⇨ Those being asked for consent should probably assume that some limitations will apply to the exercise of absolute discretion.

DRAFTING IMPLICATIONS

As a result of these cases, we believe new 'boilerplate' provisions will begin to be seen setting out when consent will be considered to have been reasonably withheld.

⇨*Some suggested drafting:*

"*Where the consent of either party is a requirement under the terms of this Agreement and that consent is not to be unreasonably withheld, in assessing whether consent has legitimately been withheld, due account must be taken of:*

- ◊ *the balance of the respective interests of both contracting parties; and*
- ◊ *the consequences to each should consent be granted or withheld, as the case may be.*"

Optional additional wording:

"*In deciding whether or not to give consent, regard may only be had as to the suitability of the sub-licensee/ assignee in question for that particular position.*"

Conclusion

The obligation to act reasonably does not seemingly require any 'balancing of interests' as one might perhaps expect. Instead, the party from whom consent is sought is apparently entitled to take a completely 'one eyed' view, which does not seem entirely 'reasonable'.

REASONABLE ENDEAVOURS

What does an obligation to use 'reasonable endeavours' mean?

Unfortunately, there is no clear meaning of this term. A variation of this phrase was considered in the case of *Blackpool Airport v Jet2.com* [2012].

The Airport had an obligation to use 'all reasonable endeavours' to promote Jet2's services and to provide a cost base that would facilitate Jet2's low cost pricing.

The question was to what extent was the Airport entitled to take into account the cost of it fulfilling such obligations?

The Court of Appeal said, "*whether and to what extent a person who has agreed to use his … endeavours can have regard to his own financial interests will depend very much on the nature and terms of the contract in question*".

The Airport contended that it was no longer obliged to accept Jet2 flights outside its normal operating hours because that was contrary to its own commercial interests.

This argument reflected decisions in previous cases, most notably *Yewbelle v London Green Developments* [2006]. In that case, the judge expressed the view that Yewbelle was not required to sacrifice its own commercial interests in carrying out its obligation to use reasonable endeavours.

In *EDI Central v NCP* [2010], it was again held that an obligation to use 'all reasonable endeavours' does not require a party to act against its own commercial interests.

These cases very much follow a fairly traditional definition of an endeavours commitment namely that "*a company is not expected to do more than could reasonably be expected of a prudent board of directors acting in the interests of its shareholders*".

The Court of Appeal in the *Blackpool Airport* case ultimately decided that given the facts, the Airport could not refuse to accept flights outside of normal operating hours even if that caused it to suffer a loss.

In other words, to some degree it was obliged to 'sacrifice its own commercial interests', even though the precise extent of that obligation was uncertain.

In *Telford Homes v Ampurius Nu Homes (CA)* [2013], a 'reasonable endeavours' obligation to complete works was not satisfied simply by having used reasonable endeavours to obtain the necessary financial resources to carry out the works.

Such a commitment could not be fulfilled by a party arguing that it had not obtained the necessary funding unless there was express wording to this effect.

A commitment to use 'all reasonable endeavours' was made much more certain by an express objective threshold of exactly when action was required in *Bristol Rovers Football Club v Sainsbury's (CA)* [2016]. Sainsbury's was not found to be in breach of that commitment because the threshold had not been met.

WHAT DOES THIS MEAN?

What do the cases on 'reasonable endeavours' mean?

The cases on reasonable endeavours are not particularly helpful or illuminating!

As one of the Court of Appeal judges in the *Blackpool Airport* decision noted, previous cases had not featured any extended discussion of what 'sacrificing one's own commercial interests' might involve.

Another judge commented that there is an inherent uncertainty in the concept of 'reasonable endeavours' and what is reasonable will very much depend upon the individual financial circumstances of the organisation which has the obligation:

"*The fact is that a Court would be unable to reach a conclusion as to the reasonableness of the [actions] without being given a series of assumptions as to the nature, means and management aims of the hypothetical [party in question].*"

Some commentators have also suggested that one of the determining factors in *Blackpool Airport* was that the matters which were the subject of the obligation were entirely within the Airport's own control.

Perhaps more important was the fact that the Airport was looking to change the status quo at very short notice in circumstances where Jet2 was forced to make emergency alternative arrangements at considerable additional cost and inconvenience to its passengers.

DRAFTING IMPLICATIONS

- Any drafting of 'reasonable endeavours' provisions has to address:
  - ◊ the lack of clarity surrounding the extent to which commercial interests must be 'sacrificed';
  - ◊ the inherent conflict between acting in one's own best interests where an obligation can only be fulfilled at a loss and the duty owed to comply with contractual commitments to the other party; and
  - ◊ the uncertainties introduced by assumptions surrounding the attributes of the party whose conduct is being judged.
- With this in mind, we would suggest attempting to define what 'reasonable endeavours' is intended to mean.

⇨ *some suggested drafting:*

"*Where used in any part of this Agreement, the phrase 'reasonable endeavours' shall be taken to mean an obligation to do whatever should reasonably be done in the circumstances by a responsible and reasonably funded service provider (in the case of the [name of service provider]) or a responsible customer receiving the Services (in the case of the [name of customer]), as the case may be, to fulfil the obligation concerned and the commitment to the other party.*"

ACTING REASONABLY

What does an obligation to 'act reasonably' mean?

Again, there is no clear definition of what this phrase means.

English law does not traditionally recognise any general obligation on a contracting party to 'act reasonably' in its contractual dealings nor does it impose a general obligation on contracting parties to act 'in good faith' towards each other.

Having said that, contracting parties do not have complete freedom in the way that they act or seek to enforce contractual obligations.

Duty to co-operate

The case of *Anglo v Winther Brown* [2000] was an example of the application of a long-established legal principle of a 'duty to co-operate'.

This duty involves both parties working together to resolve problems which arise (and which ought reasonably to have been expected) and the customer accepting, where possible, reasonable solutions to any such problems.

This was a reference to the principle from the very old case of *McKay v Dick* [1881] in which the judge said that in a written contract, "*where it appears both parties have agreed that something should be done which requires both parties concurring to do it, the construction of the contract will be that each party agrees to do its part to carry out that thing*".

This duty will be implied and applies even if there are no express words to this effect in the contract.

So both parties must work together to facilitate the performance of the contract and must not do anything to actively frustrate performance by the other party.

It is extremely difficult to see how the duty to co-operate could be excluded contractually.

IMPLIED OBLIGATION?

Will the Courts impose an implied obligation to act reasonably?

Yes, but reluctantly. The case of *Durham Tees Valley Airport v BMI* [2010] emphasised that the Courts are extremely disinclined to imply or impose an obligation on a party to 'act reasonably' when exploiting its contractual rights.

The Airport reached a 10 year agreement with BMI for BMI to base a minimum of two aircraft at the Airport and thereafter to operate a flying programme from the Airport.

The value of the contract to the Airport was dependent upon the volume of passengers since it earned a fee per passenger.

Also, the greater the number of passengers using the Airport, the greater revenue that would be earned from shops, restaurants and car parking.

It was therefore critical that BMI actively exploited its rights and promoted the airport as a departure point.

The Court of Appeal considered whether the contract contained an implied term that BMI would operate the aircraft in a manner that was 'reasonable' in all the circumstances. The Court said that it would not imply such a term.

Under the contract the questions of how many flights BMI scheduled and to which destinations were held to be matters for the airline's discretion.

However, BMI had been in breach of contract on other grounds.

The Airport argued that when assessing the compensation due the Court should look at the level of profit that would have been made had BMI acted 'reasonably'.

The Court declined to follow that approach. Instead it said that when awarding damages in circumstances where the performing party has discretion regarding how to act, the Court had to:

- conduct a factual inquiry as to how the contract would have been performed had it not been breached;
- look at the relevant economic and other surrounding circumstances to decide on the level of performance which BMI would have adopted; and
- assume that BMI would not have acted outside the contract terms but would have performed the contract in its own interests having regard to the relevant factors prevailing at the time.

Limits on express obligations to act reasonably

In *TSG v South Anglia* [2013] there was an express requirement for the parties to: "*work together … in the spirit of trust, fairness and mutual co-operation*" in relation to their "*roles, expertise and responsibilities*".

There was a separate express duty to "*act reasonably*" in relation to "*all matters governed by the contract*".

It was held that a termination for convenience under the contract was not a 'responsibility', it did not give rise to a 'role' nor was it dependent upon any 'expertise'.

Consequently these limitations did not affect the right to terminate for convenience. Equally, this was an absolute and unqualified right.

Accordingly the clause did not require the party which terminated to act reasonably in exercising this right.

⇨In the absence of a provision to act reasonably in exercising a termination right, the Court was not willing to imply one.

DRAFTING IMPLICATIONS

- As the Courts are very reluctant to impose an implied obligation on a contracting party to act 'reasonably' particularly where it is not absolutely essential to do so, it is important when drafting to be explicit about precisely what minimum level of performance is expected from the other contracting party to fulfil an obligation.
- In other words, think about what the other party would be expected to do for it to be considered to have acted reasonably.

INCREASING FEES

Limitations on a right to increase fees

This issue was considered in *Esso v Addison* [2003]. Esso was a party to a number of licence agreements allowing licensees to operate petrol stations under the Esso brand.

It reserved the right to review the licence margin and the sum payable in respect of a monthly operating costs allowance.

Following such review, Esso would notify the licensee and if, in its opinion changes were required, they would take effect from the following December.

Esso also reserved the right to make adjustments to the margin and/or the costs allowance at any other time simply by notifying the licensee.

The questions for the Court were:

- was Esso permitted to act entirely subjectively, as it thought fit?
- what limitations were there, if any, on the freedom of Esso to act?

The Court decided that the words in the contract were unambiguous and entirely effective to permit Esso to act subjectively as it thought fit.

However, it had to examine not just the language of the contract but also its context.

Terms implied

The Court implied two terms into the contract:

- although it found that Esso had acted entirely rationally and in good faith, the Court implied a term that Esso should not act "*arbitrarily, capriciously or irrationally*" (mirroring the phraseology used in the *Product Star* case);
- it then said that even when acting honestly and in good faith, Esso could not adjust the margin, fees and operating costs allowance to make it commercially impossible for the licensee to operate the service station and therefore deprive it substantially of the whole benefit that it was intended to obtain from the remaining life of the agreement.

Where there is discretion to fix charges

In *Yilport v Buxcliff* [2012] the Court said that where a party to a contract has discretion to fix rates and charges, that does not mean that the party's decisions could be questioned only if they were so unreasonable that no person acting reasonably could have made them.

In the context of an agreement to pay 'all charges', the judge implied a term that the charges had to be 'reasonable' in the circumstances even though there was no apparent restriction on the use of the discretion.

A discretion to fix prices is a special and somewhat exceptional situation and whilst this is relatively rare, where this is the case it seems that the contracting party will have to justify the objective reasonableness of the charges which it seeks to make.

Is a right to review charges, a right to increase them?

Basically, no. This point was looked at in *Amberley v West Sussex County Council* [2011] and raised similar issues to those in the *Esso* case.

Amberley had contracts with WSCC to provide residential care home services.

It sought to increase its fees unilaterally relying on a provision within the agreements which stated that: "*The level of fees is subject to review as costs increase*".

The Court decided that the wording was not sufficiently clear to confer a unilateral right to increase the fees.

'Review' meant literally review, entitling Amberley to review the fees but requiring WSCC's agreement to actually increase the fees and so vary the contract.

INCREASING FEES UNILATERALLY?

Can a party unilaterally increase fees?

Yes. Contracting parties are free to agree one-sided clauses which allow one party to unilaterally vary a contract to the detriment of the other such as putting up prices, subject always to the implied term that such a right would not be exercised dishonestly, for an improper purpose, capriciously or arbitrarily.

DUTY TO MITIGATE

Is it necessary to act reasonably in relation to the duty to mitigate?

Yes - after a breach of contract has occurred, the injured party is obliged to make reasonable efforts to limit any additional losses it may suffer. Failure to do this may prevent the injured party from obtaining compensation from the other party for avoidable losses. This is referred to as the 'duty to mitigate'.

There are two requirements for the duty to mitigate, the injured party must:

- take reasonable steps to minimise its loss; and
- not take unreasonable steps to increase its loss.

Where an injured party incurs expenses or losses as a result of taking reasonable steps to mitigate, it can recover those expenses or losses.

Adequate mitigation

The duty to mitigate featured in the case of *Lombard North Central v Automobile World* [2010]. The steps carried out by Lombard to mitigate its loss were found to be sufficient.

Automobile World failed to keep up the payments under a hire purchase agreement ("**HPA**") with Lombard for a rare and expensive car. Lombard terminated the HPA and repossessed the car. It sold the car privately but for much less than the total purchase price under the HPA.

The sale followed an initial attempt to organise a 'fax auction' which had been even less successful in securing adequate offers.

Lombard then sought the balance of its loss.

Automobile World contended that Lombard had failed to adequately mitigate its loss.

It transpired that the whole process of selling the car from the point it had been repossessed had taken 11 days. No effort had been made to sell the car through a specialist dealer which may have maximised the price obtained.

Also, at the time of entering the HPA, Lombard had a written indication that the car's value was about £194,000, substantially more than its eventual sale price.

Despite not taking the most obvious course of action, the Court of Appeal said that Lombard had adequately mitigated its loss given that it had to make what was effectively a 'forced sale'.

Is the duty to mitigate onerous?

No - the case of *BSkyB v EDS* [2010] illustrated that the duty to mitigate is not a terribly onerous one. The standard of reasonableness in this context is not judged with 20:20 hindsight.

BSkyB was found to have adequately taken steps to mitigate its losses in taking an IT project back in -house, even though it had spent much more than the original contract price and it had taken longer than if it had employed an expert systems integrator.

In *Woodlands Oak v Conwell (CA)* [2011] a customer instructed a third party to rectify defective work without giving the original building contractor an opportunity to correct the problems he had caused; this amounted to a failure to mitigate loss.

The innocent party does not actually have to do or consider much in order to satisfy the obligation to act reasonably in mitigating its losses. In particular, it does not have to tolerate or accept sub-standard proposals or arrangements from the breaching party for fear of forfeiting its claim for compensation.

In most cases the innocent party is obliged to explicitly invite a more detailed proposal. Any offer made by the breaching party must contain all relevant information to enable the innocent party to make a reasonable assessment of the offer and a fully informed choice (*Manton Hire v Ash Manor Cheese (CA)* [2013]).

⇨The duty to mitigate is clearly not a particularly demanding one - maybe to reflect that the party in breach places the innocent party in a difficult situation.

Burden of proof

The burden of proof is on the wrongdoer to demonstrate there has been a failure to mitigate. The innocent party only has to do what is 'reasonable' in the circumstances.

However, it is wise for the mitigating party to present compelling evidence that it did take reasonable steps to mitigate.

Is the innocent party obliged to incur any significant expense in mitigating a breach where it simply does not have the budget?

Few, if any, of the cases dealing with mitigation address this difficult question.

We believe it may be a perfectly legitimate argument to say that the duty to act reasonably in mitigation does not oblige the innocent party to incur significant additional costs, including funding staff to work on an overrunning project.

What is reasonable depends upon the mitigating party's resources. If the innocent party has very limited funds, the party in breach cannot expect it to spend money that it does not have on reducing its losses.

Certainly in different situations the Courts have been reluctant to require innocent parties to risk their own money (to finance litigation, for example), although each case will always depend upon its own facts as to the sums involved and the degree to which such expenditure would be certain to reduce the loss.

DUTY OF GOOD FAITH

Is there a duty of 'good faith' under English law?

Not as such. There is an overriding duty of 'good faith' imposed by law in many continental European jurisdictions but such a duty is not generally implied under English law (at least not in those terms).

However, express obligations of good faith do seem to be appearing in English contracts.

Dispute regarding express duty of 'good faith'

An express duty of good faith was at the core of a dispute in the case of *Mid Essex Hospital NHS Trust v Compass Group (t/a Medirest) (CA)* [2013].

The Trust entered into a long-term catering agreement with Medirest under which Medirest had to co-operate in good faith and take all necessary reasonable action so that the Trust could receive the full benefit of the contract.

There was also a service failure point ("**Point**") mechanism which enabled deductions to be made from payments.

Significantly, Points applied on an on-going basis until Medirest either remedied the performance failure to the Trust's satisfaction or it had taken steps to prevent its recurrence.

There were some initial problems and although improvements to the overall service were made, the Trust issued a formal warning notice in December 2008 which triggered an obligation on Medirest to prepare an action plan.

The plan was finally agreed in January 2009.

At that point the Trust stated that Medirest had accrued nearly 53,000 Points and the deductions for the six months to December 2008 came to more than £590,000 - over half the normal service fee payable for the period to which it related.

Overegging the Points

The Trust had interpreted the Points regime so that multiple Points and huge service credits accrued from each of the original minor service failures. Medirest contested this and calculated only about 19,000 Points had accumulated with a much smaller deduction of over £37,000.

Its view was that Points stopped running once the Trust knew the failure had been rectified or had been told of the steps taken to remedy. The Trust instead insisted on formal e-mail notification for each and every incident.

Withholding payment

Despite attempts to resolve the dispute, the Trust started to withhold substantial sums from payments due to Medirest.

Medirest sent a notice to the Trust stating that it was in material breach and demanding that the Trust pay the sums withheld and re-issue a corrected Point schedule explaining the basis of the deductions claimed. If the Trust did not, Medirest threatened that it would exercise its right to terminate the contract.

The Trust paid the sums withheld but did not re-issue the relevant schedule until much later. Medirest consequently served a termination notice.

The Trust then served its own termination notice as Medirest had incurred and continued to incur more than the permitted number of Points that was the threshold for termination.

After further negotiations, the parties agreed the contract would terminate in October 2009 without prejudice to whose termination was effective.

The High Court decided that Medirest was entitled to terminate for the Trust's material breach of its obligation to co-operate in good faith.

The Trust appealed.

The Court of Appeal found that:

- as a matter of interpretation, the express contractual duty to co-operate in good faith was limited to certain defined purposes and could not be expanded to relate to the conduct of the parties more generally. The obligation applied to certain purposes but would not qualify or reinforce all of the parties' obligations in all situations where they interacted, as Medirest had contended; and

- this was a very detailed contract, where the obligations of the parties and the consequences of any failings were spelt out in great detail. Therefore, commercial common sense did not favour a general overarching duty to co-operate in good faith.

It was held that:

- the Trust's conduct in awarding itself excessive payment deductions and Points was not a breach of the express duty of 'good faith' obligation as:
  - ◊ the Trust was not acting dishonestly in applying the calculation provisions; and
  - ◊ the deductions and Points were irrelevant to the purposes set out in the relevant clause;
- neither party had committed any other breach of the 'good faith' obligation.

Implied term to not exercise discretion in an 'arbitrary, capricious or irrational manner'

Although exercising a contractual discretion may be subject to an implied term to refrain from exercising it in an arbitrary, capricious or irrational manner (as seen above), this did not apply to the application of service credits.

The only element of discretion was a simple decision as to whether or not to claim the payment deductions or Points due to it.

If the Trust awarded more than the correct number of Points or deducted more than the correct amount, then that was a breach of the express provisions of the relevant clause.

There was no need for any implied term to regulate the operation of that clause so the Trust could not be in breach of any such implied term.

For such a term to be applicable, the discretion had to comprise an assessment of and choice from a range of options in which both parties' interests were relevant.

By way of contrast, in *Portsmouth City Council v Ensign Highways* [2015], it was found that an award of service points did involve an exercise of discretion as the award depended on the gravity of the breach in each case. There was therefore an implied term not to act in a manner that was 'arbitrary, irrational or capricious'. The same points were awarded regardless of how serious the breach was so this amounted to a breach of the implied term.

Clear words needed

It was argued in *Fujitsu Services v IBM United Kingdom* [2014] that an obligation to carry out certain services in accordance with '*Good Industry Practice*' meant there was an express duty to perform those services in good faith.

However, the Court decided that for there to be such an express duty of good faith, there would need to be clear words to this effect.

DRAFTING IMPLICATIONS

- The inclusion of an express 'good faith' commitment in a contract would seem to offer a degree of protection for both contracting parties although possibly at the expense of a little less certainty in terms of enforcement of the contract's express terms.
- We are already beginning to see express 'good faith' duties becoming more frequent in contract drafts, although the parties need to state this clearly if it is the intention to impose such an obligation. Such duties are probably something that English and other lawyers from common law backgrounds will simply have to get used to and advise their clients accordingly.

SUMMARY

Some of the main points to take away

- The onus is on the party seeking consent to establish, on the balance of probabilities, that the party withholding consent has acted unreasonably.
- The party withholding approval/consent only needs to prove that a person acting reasonably might have come to the same decision and does not have to balance the interests of both parties.
- Where a party has discretion as to how to act, that discretion must be exercised honestly and in good faith and not arbitrarily, capriciously or unreasonably.
- The concept of 'reasonable endeavours' has an inherent uncertainty and what is reasonable will very much depend upon the individual circumstances of the organisation which has the obligation.
- There is an implied obligation that both parties must work together to facilitate the performance of the contract and must not do anything to actively frustrate performance by the other party.
- The Courts are extremely reluctant to impose an obligation on a party to 'act reasonably' when exploiting its contractual rights.

- Regarding the duty to mitigate, the burden of proof is on the wrongdoer to show there has been a failure to mitigate. The innocent party only has to do what is 'reasonable' in the circumstances which is not very onerous.
- A contractual 'good faith' obligation requires the parties:
  - ◊ not to take unreasonable actions which might damage their working relationship; and
  - ◊ to be faithful to, and not undermine, the agreed common purpose of the contract, to observe reasonable commercial standards of fair dealing and to act consistently with justified expectations.
- We are likely to see an increasing number of express obligations of good faith and lawyers and clients will need to keep up to date with what impact this may have on contracts governed by English law.

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To find out how TRG might be able to help, please contact us at info@TRGlaw.com or contact one of the directors:

Paul Golding	p.golding@TRGlaw.com	+44 (0)1483 730303	+44 (0)7974 351750
Tracey Tarrant	t.tarrant@TRGlaw.com	+44 (0)1273 277429	+44 (0)7957 366684
Angela Cornelius	a.cornelius@TRGlaw.com	+44 (0)118 9422385	+44 (0)7710 055249

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